In the Superior Court of the State of California in and for the City and County of San Francisco.

Department No. 1.

Honorable JAMES M. SEAWELL, Judge.

Crocker National Bank
vs.
Byrne & McDonnell.
No. 53,644

Thursday, September 16, 1915.

ORAL OPINION.

The COURT. There are three principal questions involved in this case. The first is whether, inasmuch as the bonds in controversy were stolen by Baker from the plaintiff, he could confer any title upon the defendant. The second question relates to the consideration paid by defendant for the bonds, and the third is whether the plaintiff is estopped by reason of its conduct in permitting Baker to assume the indicia of ownership of the bonds.

It is claimed on the part of the plaintiff that inasmuch as the bonds were secured by mortgage they were not negotiable and that defendant, therefore, even although a purchaser in good faith and for value, could not acquire any better title than Baker had. The proposition that the bonds were not negotiable is based upon the recent decision in Kohn v. The Sacramento Electric Gas & Railway Company, 168 Cal. 1, in which it was held that coupon bonds of a corporation, although payable to bearer are not negotiable if secured by a mortgage of which the holder of the bonds had notice. That case merely decides that the rights of the holder were subject to any defenses which the corporation had. It did not involve the title of a bona fide purchaser for value, and without notice of a defect in title.

From the fact that the bonds are not negotiable so far as the obligors are concerned, it does not follow that they are likewise not negotiable as between successive holders of the bonds. This is a distinction for which I may have no warrant in any judicial precedent. To say that successive holders of the bonds are subject to the rules which apply to negotiable instruments may be said to be judge-made law, but I have the authority of ex-President Taft for saying that judge-made law is the best. He ought to know for he has been a judge himself.

I will read what Mr. Daniel says as to the character of a coupon bond:

> "It is issued by the Federal Government, by states, by territorial governments, or the local divisions thereof, by municipalities, by railroads, canals, and steamboat companies,

> and all manner of trading corporations. A vast portion of the wealth of the country is represented in 'coupon bonds'. The reports of all the courts have been filled for many years past with decisions, respecting their nature and uses. Every banker, merchant, capitalist, and business man is deeply interested in the law concerning them."
>
> 2 Daniel on Negotiable Instruments, sec. 1486.

So you see what a broad field is covered by securities of this character.

Now, the circumstance which, under the Kohn case, permits the maker of a bond to set up a defense against the holder is one which adds to its market value and enables the maker of the bonds to put them upon the market.

There are two features which affect the actual negotiability of a bond. One is, that it is secured by mortgage, and the other is the acceleration of the maturity of the bond by a provision that if the interest is not punctually paid, then the principal becomes due at the election of the holder. If the bonds are not secured, I apprehend they would have very little circulation, and particularly among bankers. In case the coupons are not paid as they fall due and the only remedy of the holder is to bring suits for the interest as the coupons fell due and he had to wait for years for the principal, I apprehend that there would be considerable difficulty in negotiating such securities.

Now, these securities are of a peculiar nature. They stand in a class by themselves. They may be called negotiable, or by any other name you may deem appropriate, but they are, in fact, more current than any other form of negotiable paper, much more so than an ordinary promissory note would be. Banks and bankers are particularly interested in the establishing of a rule which will protect the purchaser of such securities where he pays a valuable consideration and receives them in good faith without notice of any defect of title on the part of the seller. They are expressly designed to pass from hand to hand, and by actual usage are so transferred. There are large numbers of these bonds in controversy, 28,000 of the Spring Valley Water Company bonds of one thousand dollars each, payable in twenty years. The Market Street Railway bonds are payable in thirty years.

I do not think we ought to stop to consider the rules applicable to bills of exchange and promissory notes when we come to transactions of this kind. These bonds are designed to be put upon the market, and to be the subject of investment by moneyed men. It is not important to call them negotiable instruments. Custom has fixed their character, regardless of any other test, and it may be important to note that at the last session of the Legislature, which was the first Legislature which met after the

decision in the Kohn case, section 3088 of the Civil Code was amended.

The original section provided that a negotiable instrument must be payable without any condition not certain of fulfillment. It was amended in 1905 so that there may be a provision for the payment of attorneys' fees and costs of suit, and at the last session of the Legislature it was further amended by adding a proviso "that bonds made payable to bearer shall be negotiable notwithstanding any condition contained therein or in the mortgage, deed of trust or other instrument securing the same".

The effect of this amendment is that, notwithstanding a condition for acceleration of the maturity of bonds payable to bearer, and notwithstanding the fact that they are secured by mortgage, hereafter they shall be negotiable. The amendment does not say in express terms that bonds secured by mortgage shall be hereafter negotiable, but it says that "bonds payable to bearer shall be negotiable notwithstanding any condition contained therein, or in the mortgage, deed of trust or other instrument securing the same".

I do not understand the decision in the Kohn case to apply to bonds secured by a deed of trust.

So I shall hold that the fact that these bonds were secured by mortgage does not prevent them from being subject to the rules which apply to purchasers of negotiable instruments, and that even although these bonds were stolen, if the defendants paid a valuable consideration for them and had no notice of any defect in Baker's title, they acquired a good title.

The next question is in reference to the consideration. It is claimed on the part of the plaintiff that the transaction between Baker and the defendants was a gambling one, and that no legal rights could grow out of it. Section 26 of Article IV of the Constitution, as far as this question is concerned, applies only to contracts for the sale of shares of stock, but I presume that the rule as stated there is a good statement of the law as to the sale of all commodities. Whoever got up this edition of the Constitution has headed this section "Lotteries and Bucketing Prohibited". I am not aware of ever having seen in literary composition the word "bucketing". I confess that I am somewhat unsophisticated in regard to stock transactions. I should hesitate, even now, to publicly state what my idea of "bucketing" is.

The first question in my mind is whether this provision applies to a transaction between the broker and his customer.

> "All contracts for the purchase or sale shares of the capital stock of any corporation or association without any intention on the part of one party to deliver, and of the other party to receive the shares, and contemplating merely the payment of differences between the contract and market price on divers days, shall be void, and neither party to

any such contract shall be entitled to recover any damages", and so forth.

It will be observed that in order to render the contract illegal there must not only be the absence of an intention to deliver or receive, but that the parties must contemplate the payment of differences.

Now, there was no contract between the defendants and Baker by which one party agreed to buy from the other, or to sell to the other, or by which, at the time of the execution or performance of the contract, it was provided in any way for a settlement by the payment of differences.

As far as the relations of Baker and the defendants are concerned, I adopt as my view the opinion of the Supreme Court of the United States in the case of Richardson v. Shaw reported in 209 U. S. Supreme Court Reports, page 365. The original section 26 of this article of the Constitution prohibited contracts for the sale of shares of stock on margin. Undoubtedly, the transaction between Baker and the defendants was just such a one. It was a sale of shares of stock on margin. That provision has been repealed by the recent amendment of section 26, and it is no longer illegal to buy and sell shares of stock on margin.

Now, am I to hold that notwithstanding that repeal, it is still illegal to sell shares of stock on margin? That, of course, cannot be contended for a moment. If the transactions between Baker and defendants were simply sales and purchases of shares on margin, they were lawful transactions. I am at a loss to see wherein they differ from the sale and purchase on margin as defined by the Supreme Court in the decisions under the original section. The Supreme Court gave, I think, a very strained construction of the relations between the broker and the customer. It must, however, be borne in mind that what the Supreme Court intended was to hold void the transactions which that section of the Constitution was intended to prohibit. They thought that it was intended by the framers of the Constitution to prohibit just such transactions as those in which Baker and the defendants engaged.

Now, there was no contract between Baker and the defendants for the sale by the defendants to Baker, or the purchase by Baker from the defendants of any shares of stock, so there could be no question between them of settlement by the payment of differences.

It is claimed by the plaintiff's counsel that it makes no difference whether or not the defendant executed the orders of Baker when he gave orders to buy or sell, but that the legality of the transaction depends upon the contract between Baker and the defendants in which they were principals, but that proposition assumes that there was a contract between them by which one bought from or sold to the other. There was no gambling on

the part of the defendants. They made nothing by the rise or fall of the market. When Baker gave an order to buy stock they bought, and when he ordered them to sell, they sold the stock, and obtained the stock to deliver to the purchaser.

In accepting Baker's orders defendants expressly stated, "All orders for the purchase or sale of any article are executed with the distinct understanding that actual delivery is contemplated, and that the party giving the order so understands and agrees".

The position of plaintiff's counsel is that that language is merely colorable, and that the court should look through the transaction and see what the intention of the parties really was. The brokers were not buying from or selling to Baker. When an order was given by him they executed the order. After a while it appeared that Baker was engaging in extensive stock transactions, and on the theory of plaintiff's counsel, although at first they might have been deceived in thinking that Baker was sincere in giving those orders and that actual delivery was contemplated by him, yet when the transactions became extensive and involved large sums of money they should have gone to Baker and said "You seem to be gambling and to be merely speculating upon the rise and fall of the market". Was it any part of the defendants' duty to have done that? Would not Baker have properly replied, "It is none of your business. If you don't want my custom I will go somewhere else". That would have been the end of it, would it not?

The differences of opinion of the different courts who have considered these questions are somewhat remarkable, and seem to be somewhat dependent upon the temperament of the judges who decided them. For my part, so far as the defendants here are concerned, I do not see that they can be said to have engaged in any gambling transaction. It certainly takes two to gamble. I do not understand how only one can gamble. A broker who negotiates a contract between two other persons, although they may be gambling and speculating on the rise and fall of the market, unless he has notice of it, has the right to recover the moneys he expended in carrying it out.

In the case of Embrey v. Jemison, reported in 131 U. S., page 336, the court sustained the defense in a suit brought by the broker which stated in substance that it was a gambling transaction, and that the plaintiff knew all about it, and negotiated it, but that case arose on a demurrer to a plea which stated a very aggravated case of gambling on the part of the principals to the contract. It was further alleged that the brokers knew all about the character of the transaction. Here the defendants simply bought and sold on the stock board in New York, and did not come in contact with any of the purchasers or sellers. Suppose the defendants had sued Baker for advances which were the consideration for the pledge of these bonds? Could he have

said "I did not intend to deliver, or accept the delivery of those stocks"? Would that have been a defense in the face of the written declaration of defendants in accepting his orders, that an actual delivery was contemplated? Could he have said, "You should have seen through my transactions with you and known that I was gambling."

So I will hold that the consideration for those bonds was not an unlawful one.

The other question is whether plaintiffs are estopped by reason of the powers which they permitted Baker to exercise. Without going into particulars I will state that I think I am in line with the decisions of the Supreme Court of this state, in holding that the conduct of the plaintiff was not such as to estop it from recovering these bonds, so far as that point is concerned. I do not think that the answer in this case is quite sufficient. It should have been stated as a separate defense. I make no point of that, further than to call counsel's attention to the fact, that it was not stated as a separate defense. Here is what it says, "Alleges that long prior to the time when said Baker delivered to the defendant and defendant took from said Baker the possession of, the bonds and coupons referred to in said count, the plaintiff allowed said Baker to assume and have full and unqualified possession of said bonds and coupons and power to dispose of the same, together with all the ordinary and usual indicia of ownership appropriate to property of the nature and description of said bonds and coupons, and the apparent ownership thereof so as to enable said Baker to make a transfer thereof".

There is no allegation there of any continuous possession by Baker of these bonds. It says that at some time in the distant past the plaintiff allowed said Baker to assume and have possession of said bonds and coupons. Without reference to the sufficiency of the allegation I do not think the evidence is sufficient to create an estoppel. It could not be said that those bonds were continuously in the possession of Baker. They were in the safe of plaintiff. He had access to them; when securities were to be sold he was the person to go there and get them and deliver them to the purchaser. When coupons were to be collected he was the person to get the coupons without any person accompanying him, but I do not think I would be justified in saying that he had possession of those bonds, except when he actually removed them from the safe.

I think, if I find at all on this matter, I will simply find the facts as developed by the evidence, and in preparing these findings, I suggest to defendant's counsel to state the facts as he understands them with reference to the powers exercised by Baker with the consent of the officers of the bank. That statement may be criticised by the plaintiff's counsel by preparing an amendment to the findings.

Mr. HARRISON. Your Honor, then, will grant me leave to amend the answer so as to plead that as a separate defense, and to make the amended answer cover the facts established by the evidence at the trial?

The COURT. Yes, and the judgment will be for the defendants.

Review of Recent Cases

ONE of the most noteworthy phenomena in a review of recent decisions in the Supreme Court and District Courts of Appeal in California during the period covered by this review is the absence of reference to the war,—a fact observable not alone in the decisions of the Pacific Coast states but in those of other states. When we examine the reports of the federal courts on the other hand, we find a large proportion of their space occupied with questions arising out of the war. This is indicative of the extensive rearrangement in legal and governmental affairs that has been brought about by our entry into the world conflict. Doubtless as time goes on questions arising out of war conditions and war legislation will find their way into the state courts, but as yet the federal courts have almost had a monopoly of litigation involving such problems.

In the field of public law, for example, there is not a single reference during this period to international law to be found in the reports of the decisions of the four courts of appeal in the State of California. Private international law, as some writers prefer to call the subject of conflict of laws, is represented by two cases only, *Estate of Boselly*[1] and *Utah State National Bank v. Smith.*[2] The first named case reaffirms the familiar doctrine of Kraemer v. Kraemer[3] that property acquired in New York and New Jersey as separate property of the husband does not lose its character and become community property because of a change of domicile to California. It is interesting to note that the courts in adopting this view have to a certain extent personified the property, separate or community, and treat it as separate despite its transmutations into new forms of ownership.

---

[1] (Aug. 8, 1918), 56 Cal. Dec. 187.

[2] (June 12, 1918), 26 Cal. App. Dec. 1195.

[3] (1877), 52 Cal. 302. See also, Warner's Estate (1914), 167 Cal. 686, 140 Pac. 583; Estate of Nicolls (1912), 164 Cal. 369, 129 Pac. 278; Brunner v. California Title etc. Co. (1914), 26 Cal. App. 35, 145 Pac. 741; Ballinger, Community Property, § 47. On the foreign law, see Arntz, Revue de droit international, 1880, 323-331.